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CORRESPONDENCE MEMORANDUM

DATE: April 28, 2004

TO: Wisconsin Deferred Compensation Board

FROM: Shelly Schueller, Director
Wisconsin Deferred Compensation Program

SUBJECT: 2003 Annual Investment Performance Report

The 2003 Annual Investment Performance Report will be presented and discussed at the May 11, 2004, Wisconsin Deferred Compensation (WDC) Board meeting. This report is used by the Board to monitor the investment options made available to participants. Overall, the WDC Program continues to experience growth as a result of both new deferrals and investment income, with assets at the end of 2003 exceeding \$1.34 billion.

The Investment Committee met on March 24, 2004, to review a draft of the 2003 Annual Investment Performance Report. Staff and committee members concurred that further review of the Janus Fund and the T. Rowe Price International Stock Fund is warranted because of their failure to meet performance benchmarks and repercussions from the continuing mutual fund industry investigations into market timing and late trading.

Portfolio managers and client relationship managers from both the Janus Fund and the T. Rowe Price International Stock Fund have been asked to attend the May 11 Board meeting, either in person or via conference call, to answer questions and provide explanations of their fund's recent performance and future outlook.

Changes to the WDC Investment Spectrum

Following the 2002 WDC investment review, the following changes were made to the Wisconsin Deferred Compensation (WDC) Program investment spectrum:

- The Dreyfus Premier Third Century Fund (Class R) was closed to new participant elections effective February 20, 2003, and will be phased out of the WDC investment spectrum entirely during 2004.
- The Calvert Social Investment Fund: Equity Portfolio (Class I) was added to the WDC investment spectrum on April 21, 2003.
- The Small Cap Equity Index Fund (Barclays Global Investors) was approved for addition to the investment spectrum. This fund opened to participants on March 1, 2004.

Reviewed and approved by Pam Henning, Office of Strategic Services

Signature _____

Date _____

WDC Fund Performance Review

The attached 2003 Annual Investment Performance Report illustrates the returns of the WDC funds compared to their established benchmarks for the one, three, five and ten year periods. Although several funds experienced negative earnings for the year, the report demonstrates that the majority of the WDC Program's core investment options met or exceeded their established performance benchmarks.

After reviewing and discussing the information on investment performance in the annual report, the Investment Committee identified the following funds as needing further examination:

- *The Janus Fund* – As of March 31, 2004, there were 19,923 WDC participant accounts in this fund with a balance of \$131,745,401.81. Of the 19,923 participants, 66% (or 13,238 participants) elected to make a deferral to their Janus fund account in March.

The Janus Fund exceeded all benchmarks for 2003 and the Lipper Large Cap Growth Funds for all periods reviewed, but it failed to meet or exceed any other benchmarks for the three and five-year periods. The fund has under performed the average large growth fund for two of the past four years.

In addition to the poor performance of the Janus Fund, there is concern regarding the overall management and direction of the Janus Capital Group. Janus Capital Group was one of the firms named in the initial investigation into trading practices in the mutual fund industry on September 3, 2003, by New York Attorney General Eliot Spitzer.

Janus Capital Group announced in a letter to Janus shareholders on April 27, 2004, that it had reached a settlement with the attorneys general of New York and Colorado and the Colorado Division of Securities. They have also reached an agreement in principle on monetary terms with the SEC, which is subject to approval by the SEC commissioners. Under the terms of the settlement, Janus will:

- provide \$50 million for investor restoration;
- pay \$50 million in civil penalties, some of which may also be used for investor restoration;
- make \$1.2 million in other settlement-related payments to the state of Colorado; and
- reduce or forego management fees by approximately \$25 million per year for the next five years.

Regulators and Janus trustees are developing a plan for how and when restoration to impacted fund investors will occur. Janus trustees are also reviewing fee reduction requirements to determine how to apply them and to which funds to apply the reduction. Janus anticipates the management fee reductions will commence on July 1, 2004.

Janus has also experienced major changes in its executive management. Mark Whitson, the Chief Executive Officer and a member of the Janus board of directors, resigned his positions at Janus effective April 20, 2004. He was replaced by Steve Scheid, who will also continue to be the Janus board chair. Whitson will remain at Janus in a "consulting" role for transition purposes until the end of 2004. Other new executives at Janus include Chief Investment Officer Gary Black, who started April 26, 2004, and Chief Operating Officer Girard Miller, who started at Janus in July of 2003.

In addition to these management changes, the executive vice president in charge of institutional services, Lars Soderberg, was recently placed on a leave of absence as a result of the firm's review of activities related to the mutual fund trading scandal. Richard Garland, the head of Janus' international business, resigned his position in November 2003 after documentation released by the New York Attorney General's office connected him to trading arrangements with Canary Capital.

- *T. Rowe Price International Stock Fund* – As of March 31, 2004, there were 13,731 WDC participant accounts in this fund with a balance of \$65,047,652.99. Of the 13,731 participants, 67% (or 9,230 participants) elected to make a deferral to their T. Rowe Price International account in March.

The performance of the T. Rowe Price International Stock Fund failed to meet its performance benchmarks for the one and five-year periods, while its three and ten-year return exceeded one of the three benchmarks. The fund has been in the third quartile of its peer group for eight of the last nine quarters.

Morningstar reclassified this fund as a Foreign Large Growth Fund as part of Morningstar's September 2003 restructuring. This new classification improves the fund's performance relative to the new peer group over recent historical periods, but it has continued to under perform the Morgan Stanley Capital International - Europe Asia Far East Index.

Recommendations

Investment Committee members concurred with staff that the Janus Fund and the T. Rowe Price International Fund have not met their benchmarks and should be more closely examined. Additional review of the Janus Fund and the T. Rowe Price International Fund is necessary to ensure these options continue to be acceptable long-term investment opportunities for WDC participants. Committee members recommended the following:

- The Janus Fund: research suitable potential replacement options. The Investment Committee further recommended "walling off" new participant deferrals to the Janus Fund for one year, until the next investment performance review takes place in 2005. Participants currently deferring to the Janus Fund could continue to do so.
- T. Rowe Price International Fund: research suitable potential replacement options.

If the Board decides to take action on one or both of the Investment Committee's recommendations, staff proposes that research and analysis of suitable alternatives be completed and presented to the Investment Committee at a meeting to be held this summer. Further recommendations for action to remove or add funds would then be presented to the Board at its November 2004 meeting, with implementation of any approved changes to occur during 2005.

Attachment